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Institutional Equity Research

APL Apollo Tubes

Steel Pipes | India

Initiating Coverage | May 07, 2020

CMP* (Rs)	1,249
Upside/ (Downside) (%)	21
Bloomberg Ticker	APAT IN
Market Cap. (Rs mn)	31,159
Free Float (%)	62
Shares O/S (mn)	25

BUY

2 Year Target Price: Rs.1,520

Market Leader at Attractive Valuation

Key Triggers

- **Investment to the tune of Rs102 trillion in the infrastructure sector, as outlined in the National Infrastructure Pipeline.**
- **Market leader in ERW pipe segment with well spread out capacities.**
- **Market leadership to sustain on robust pan-India distribution network and variety of SKUs.**
- **Higher utilisation, efficient fiscal management, and improved operating efficiency to boost profit.**

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- **APL Apollo Tubes Ltd. (APAT) is the market leader in Electric Resistance Welded (ERW) steel pipe/structural pipe segment with ~40% market share in the organised space.**
- **Its ready capacity, which stood at 2.55Mn MTPA as of FY20-end from 1.3Mn MTPA in FY17, paves the way for strong growth in the ensuing years.**
- **Premium product range, specialised application, superior realisation to drive Apollo Tricoat Tubes' (50% holding) growth and open next leg of a multi-year growth opportunity.**
- **Change in product-mix and higher utilisation of on-stream capacity will aid improvement in EBITDA/tonne and operating margin.**
- **Strong balance sheet and healthy FCF generation supported by improvement in return ratios (RoE & RoCE) make the stock attractive investment proposition.**

The COVID-19 Impact: Despite volatile steel prices, APAT has delivered a strong volume growth in FY20, and we expect the similar performance to continue as well once the economy comes out of COVID-led disruptions. However, further extension of the ongoing lockdown, if any, is likely to have negative impact on APAT's FY21E performance. We strongly believe that India's infrastructure story continues to remain intact, while APAT being a long-term play will tide over the near-term headwinds. However, in light of the uncertainties led by COVID-19 pandemic, we have presented three scenarios for APAT (Bull Case, Bear Case & Base Case) to capture slower, faster and modest recoveries, each of which are analysed in the report (Page No. 11).

Outlook & Valuation

APAT's revenue and earnings are likely to remain subdued in FY21E, which we believe to pick-up pace after 2HFY21E. Hence, we expect its revenue, EBITDA and net profit to clock 1%/4%/2.6% CAGR over FY20-FY23E, as the Company focuses to improve its operating efficiency. Further, we believe APAT deserves premium valuation compared to peers on the back of lean working capital, low debt, and ready capacity. As per our analysis change in HRC prices has a very low correlation with APAT's EBITDA (refer Exhibit 19). **Hence, we have valued the stock on PE basis by assigning a multiple of 14x on FY23E EPS of Rs 108.6, arriving at a target price of Rs 1,520 and assign a "BUY" rating on the stock.**

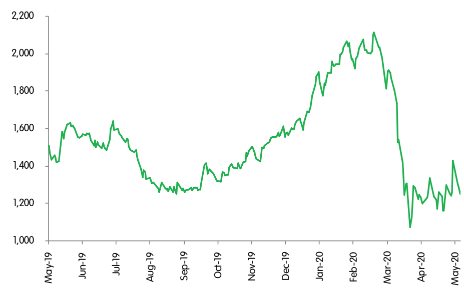
Financial Summary Y/E Mar (Rs.mn)	FY19	FY20	FY21	FY22	FY23E
Revenues	71,523	75,962	53,061	64,976	76,357
EBITDA	3,928	4,685	2,071	4,492	5,366
PAT	1,482	2,499	202	1,988	2,701
EPS	62.2	100.5	8.1	79.9	108.6
P/E	20.1	12.4	153.8	15.6	11.5
EV/EBITDA	9.1	8.0	18.3	8.3	6.8
ROCE (%)	20.0	19.4	5.2	15.5	18.3
ROE (%)	16.5	21.9	1.5	14.1	17.1

Source: Company, RSec Research

Share price (%)	1 mth	3 mth	12 mth
Absolute performance	1.4	(37.7)	(17.3)
Relative to Nifty	(4.7)	(14.6)	0.5

Shareholding Pattern (%)	Dec-19	Mar-20
Promoter	38.4	38.4
Public	61.6	61.6

1 Year Stock Price Performance



*Note: * CMP as on May 06, 2020*

We have made changes to our Recommendation and Target Price. Please refer to Page no. 20 at the end of the report.

Our Thesis

	APAT (Rs 75,962Mn- FY20)				
Key Product Segment	Apollo Standard	Apollo Structural	Apollo Build	Apollo Z	Apollo Tricoat++
Revenue (Rs mn: FY20)	8,841	36,028	4,947	16,593	7,281
Revenue Mix	12%	49%	7%	23%	10%
CAGR (FY15-FY19)	7%	37%	3%	21%	NA
CAGR (FY20-FY23E)	4%	1%	-3%	-4%	15%

Key Sectoral Theme

Infrastructure: India's infrastructure story continues to remain intact, as infrastructure development will continue to get the highest priority for economic revival of country. As per latest report of IBEF (Feb'20), India requires investment worth Rs50trillion (US$777.73bn) in infrastructure space by 2022 to have sustainable development. India plans to spend US$1.4trillion on infrastructure in the next five years.

Water Supply, Green Buildings & Green Corridors: Piped Water supply to be provided to all households in 500 cities. Outlay of Rs38.99bn (US$540.53bn) to increase capacity of Green Energy Corridor Project along with wind and solar power projects followed by up gradation of Government Medical & UGC colleges

Railways: Railways: Allocation of Rs66.77bn (US$9.25bn) for the Indian Railways, out of which Rs64.58bn (US$8.95bn) is capex, planned for modernizing railway stations & Railway Bridges across India

Airports: Government plans to establish ~100 airports in the next 15 years. Among them, 70 airports will be at new locations, while the rest will be second airports or expansion of existing airfields to handle commercial flights.

Key Investment Themes

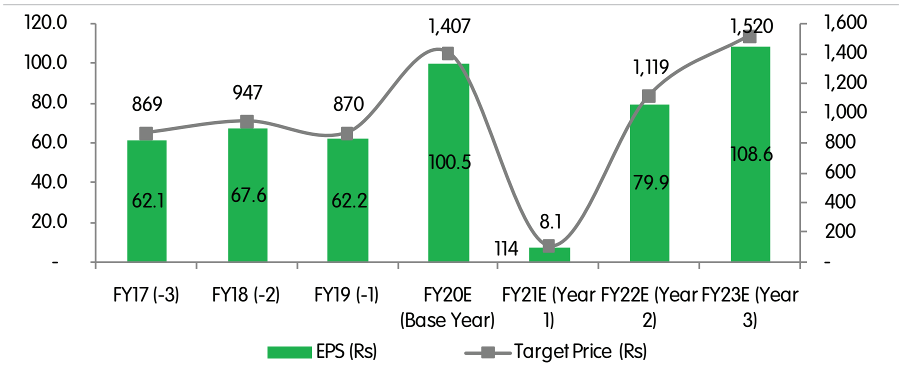
Market Leader in ERW Pipe Segment : APAT is market leaders in ERW pipes with ~40% market share in organised market and 18% market share in the overall market) with a capacity of 2.55Mn MTPA spread across 10 plants in India. APAT caters to an array of industry applications i.e. urban infrastructure, housing, irrigation, solar power plants, greenhouses and engineering. Besides this company's new product APL Tricoat has expanded its reach to home furnishing and decor (Door & Window Panels)

Capacity with Newer Technology, Higher Product SKUs & Strong Dealer Network : APAT has recently expanded it capacity (1.3MN MTPA in FY17 to 2.55Mn MTPA in FY20) backed by a superior Direct Forming Technology (DFT), resulting into increased product range (to 1,100+). Company's strong dealer network (>700) is double than that of its nearest competitor. Strong dealer network supported by Channel Financing acts as a entry barrier for new and existing player to compete in the market. Thereby making APAT a leader in ERW segment.

Efficient Financial Management reflected in its Return Ratios: APAT despite being converter in commodity industry continues to generate ROCE and ROE in excess of 18%. Resulting out of company's consistent effort in optimizing cost, efficient use of working capital followed by continuous reduction in Debt (0.6x).

Valuation: APAT's revenue and earnings are likely to remain subdued in FY21E, which we believe to pick-up pace after 2HFY21E. Hence, we expect its revenue, EBITDA and net profit to clock 1%/4%/2.6% CAGR over FY20-FY23E, as the Company focuses to improve its operating efficiency despite near term volatility in HRC Prices. As per our analysis change in HRC prices has a very low correlation with APAT's EBITDA (refer Exhibit 19). **Hence, we have valued the stock on PE basis by assigning a multiple of 14x on FY23E EPS of Rs 108.6, arriving at a target price of Rs 1,520 and assign a "BUY" rating on the stock.**

EPS & Target Price



Source: Company, RSec Research

Price Sensitivity Analysis

	EPS (Rs)	Growth (%)	FWD P/E	8.0	12.0	14.0	15.0	16.0
FY17 (-3)	62.1		20.1	497	745	869	931	993
FY18 (-2)	67.6	9.0	18.5	541	812	947	1,015	1,082
FY19 (-1)	62.2	(8.1)	20.1	497	746	870	932	994
FY20E (Base Year)	100.5	61.7	12.4	804	1,206	1,407	1,507	1,608
FY21E (Year 1)	8.1	(91.9)	153.8	65	98	114	122	130
FY22E (Year 2)	79.9	883.6	15.6	639	959	**1,119**	1,199	1,279
FY23E (Year 3)	108.6	35.9	11.5	869	1,303	**1,520**	1,629	1,738

Source: Company, RSec Research

The COVID-19 Impact

The COVID-19 Impact: Despite volatile steel prices, APAT has delivered a strong volume growth in FY20, and we expect the similar performance to continue as well once the economy comes out of COVID-led disruptions. However, further extension of the ongoing lockdown, if any, is likely to have negative impact on APAT's FY21E performance. We strongly believe that India's infrastructure story continues to remain intact, while APAT being a long-term play will tide over the near-term headwinds.

Our interactions with various stakeholders suggest:

- Hot Rolled Coil (HRC) prices will remain volatile in near term, stability in prices will only come in second half with pick-up in demand.
- Private Sector Bank continue to remain risk averse towards the sector; fresh lending to dealers for funding inventory is stopped as they await clarity on HRC prices.
- Construction activity post lockdown will take time to revive as sector grapples with migrant labour issue, impacting the demand of ERW pipes.
- Demand for agricultural pipes is likely to show some positive momentum, in preparation of early monsoon.

However, in light of the uncertainties led by COVID-19 pandemic, we have presented three scenarios for APAT (Bull Case, Bear Case & Base Case) to capture slower, faster and modest recoveries, each of which are analysed in the report (Page No. 11).

Channel Check

We spoke to a set of dealers of APL Apollo Tubes, Hi-Tech Pipes and Maharashtra Seamless as well as some retailers. We tried covering Western (Mumbai & Gujarat), Southern (AP and Karnataka) and Eastern (Chhattisgarh) while we could not reach out to any major dealer in the Northern India due to the current lockdown.

While most dealers expect the price to fall in the coming months, improving collection and managing their liquidity remain their priority. Most dealers consider channel financing extended by APAT as good alternative, as higher margin requirement and high interest rate tend to contract their margin. They witnessed good volume off-take in Jan'20 and Feb'20 and rightly anticipated a similar performance in Mar'20 (as several dealers held higher volume). However, sudden announcement of nationwide lockdown came as a shock to the dealers, with which most of them anticipate a longer time for any meaningful revival.

Western Region:

- Sudden lockdown has led to idle inventory of 15-30 days. Pre-lockdown business was normal followed by high sales both in terms of volume and value in Jan'20 and Feb'20.
- There has been no update on pricing post-lockdown by any steel pipe company.
- Maharashtra and Gujarat continue to be under tight watch, with increased number of COVID-19 patients. While none of the dealers expect the demand to come back to normal level soon, they remain hopeful that the inventory will be offloaded quickly soon after the commencement of construction activities.
- While sudden change in price by the steel pipe makers may lead to losses, most dealers remained optimistic. APAT remained a preferred supplier for the dealers, as the product quality and brand value continue to remain high.

Southern Region:

- The region witnessed similar sentiment like that of Western region. Dealers have a month of inventory and their priority is to get away with stock.
- Dealers were concerned about sudden price fluctuation.
- Demand is unlikely to witness meaningful revival, while collections continue to remain slow.

Eastern Region:

- Raipur, Chhattisgarh is 25,000MT/month market and forms a hub for eastern India. Chhattisgarh also houses a lot of steel manufacturers.
- Despite relaxation in lockdown restriction from 20th April, many steel traders are unable to open due to extended lockdown by the state government.
- APAT has a good presence in the region and mainly conducts activities through 1-2 top dealers.
- There has been no price change in recent times. Demand has flattered compared to other region owing to less industrial activity.

Comparative Analysis

	APL Apollo Tubes	Hi-Tech Pipes
Investment View		
Business	Leader in ERW Pipes with a market share of ~40% in organised space and ~18% in overall sector.	Relatively smaller player with capacity of 0.5Mn MTPA. Company has taken efforts to imrpove its presence in market despite facing high competition from organised & unorganised players.
Growth Story in current Covid-19 situation	APAT ready capacity, pre-approved products in key infrastructure projects, superior dealership network followed by higher brand recognition should lead to better growth opportunites for APAT, compared to its peers.	Uncertainty over market share loss, stiff competition from organised and unorganised player can impact Hi-Tech's growth potential.
Key Risk	Failure to utilise optimal capacity may hamper company's earnings potential.	Hi-Tech Pipes is highly leveraged impacting company's potential to deliver returns in the hands of shareholders.

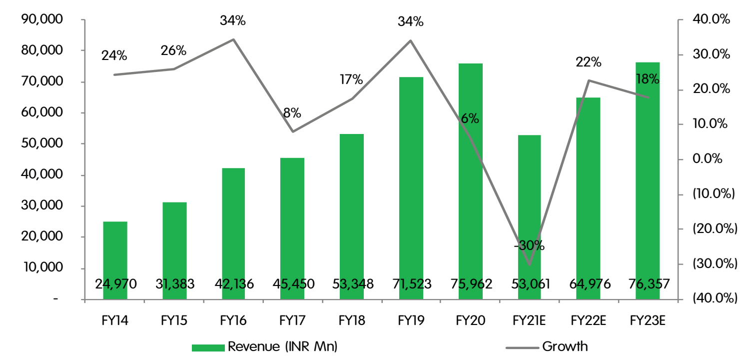
Financials (Rs mn)	FY17	FY18	FY19	9M FY20	FY17	FY18	FY19	9M FY20
Net Revenues	45,450	53,348	71,523	58,347	6,374	10,157	13,604	9,098
EBITDA	3,244	3,711	3,928	3574.8	399	601.5	747.7	448
PAT	1,465	1,605	1,482	1952.1	100.7	210.1	273.5	162
Growth (%)								
Net Revenues	7.9	17.4	34.1	15.4	26.5	59.3	33.9	(7.2)
EBITDA	26.6	14.4	5.9	40.7	25.0	59.3	33.9	(17.5)
PAT	25.7	9.6	(7.7)	126.0	55.2	108.6	30.2	(15.4)
Margin (%)								
EBITDA Margin	7.1	7.0	5.5	6.1	6.3	5.9	5.5	4.9
PAT Margin	3.2	3.0	2.1	3.3	1.6	2.1	2.0	1.8
Per share (Rs)								
EPS	62.1	67.6	62.2	80.5	9.8	20.0	25.6	19.5
DPS	12.0	12.6	14.0	16.1	0.2	0.2	0.3	0.4
Book Value	298	353	404	530	75	108	137	165
Valuation (X)								
P/E	33.3	30.6	19.3	11.9	8.3	4.0	3.2	4.1
EV/EBITDA	16.8	15.1	9.1	8.0	6.9	5.8	4.6	5.6
P/BV	6.9	5.9	3.0	2.3	1.1	0.7	0.6	0.5
Return Ratio (%)								
ROCE	21.8	22.4	20.0	19.4	13.6	17.5	17.8	13.1
ROE	23.0	20.8	16.5	21.9	14.1	22.1	21.0	13.3
D/E	0.8	0.8	0.7	0.6	2.5	2.3	1.8	1.4

Source: Company; RSec Research

Key Charts

- APAT's sales are likely to drop due to COVID-19 lockdown. Recovery will happen in H2 FY21E and growth will be back on track from FY22E.

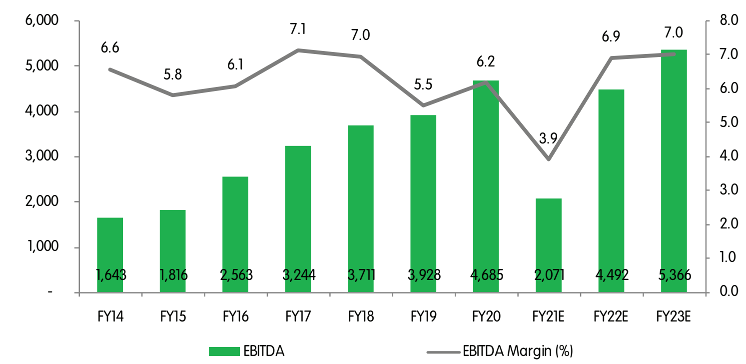
Exhibit 1: Sales



Source: Company, RSec Research

- APAT's EBITDA & EBITDA margins are likely to be impacted by COVID-19 impact in FY21. However, post lockdown with smoothening of operational margins will be back to original levels owing to its superior product mix.

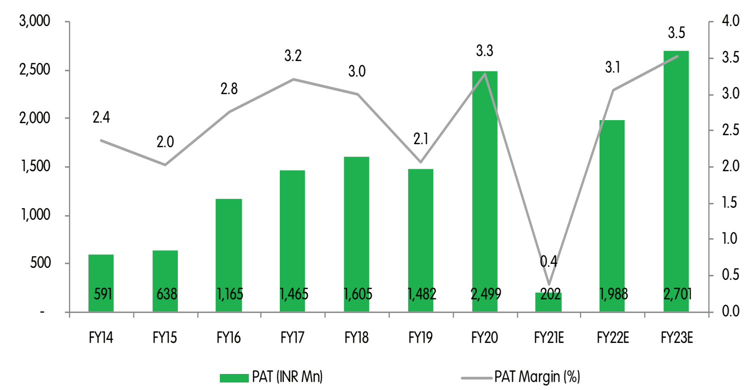
Exhibit 2: EBITDA (Rs mn) & EBITDA Margin (%)



Source: Company, RSec Research

- APAT's PAT is likely to reflect weakness in operational profit, showcasing a similar trend in recovery period of FY22E and FY23E.

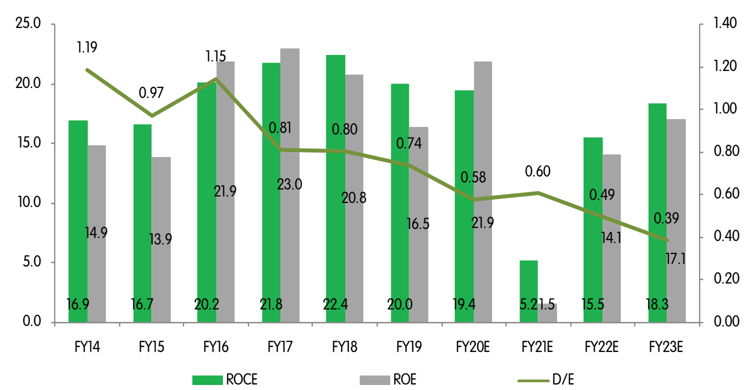
Exhibit 3: PAT (Rs mn) & PAT Margin (%)



Source: Company, RSec Research

- APAT's ROCE and ROE will take time to return to normalcy post lockdown as we factor a staggered recovery in coming years.

Exhibit 4: Return Ratios & D/E



Source: Company, RSec Research

Investment Rationale

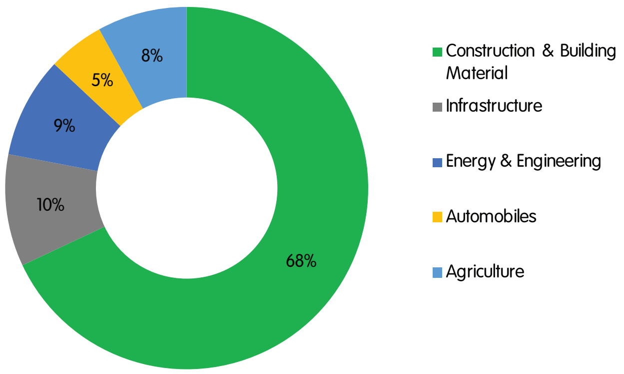
Our investment thesis is based on the following premises:

- **Pick-up in Infrastructure & Construction Space to Drive Volume Growth.**
- **Market Leader in ERW Pipe Segment – Advantage.**
- **Higher Utilisation & Efficient Financial Management.**

I. Pick-up in Infrastructure & Construction Space to Drive Volume Growth

Over the last decade, we witnessed immense penetration of structural steel into newer segments, which has been offering an edge to APAT's product portfolio. APAT is largely dependent on infrastructure sector, being a bet on India's infrastructure story. As of FY19, it used to derive ~78% revenue from infrastructure facilities and construction segment. Ten state-of-the-art-manufacturing help APAT continues to cater to an array of industry applications i.e. urban infrastructure, housing, irrigation, solar power plants, greenhouses and engineering.

Exhibit 5: APL Sectoral Bandwidth



Source: Company, RSec Research

Infrastructure spending especially for the projects having long gestation period remained largely muted during 2018-19 owing to fall of India's premier infrastructure financing company as well as General Elections. Despite severe slowdown in various segments, APAT continued its growth momentum in FY20 with 22% YoY growth in volume led by APAT's constant effort for getting approval of its products for some prestigious projects (Greenfield airport as well as railway/smart city projects).

Going ahead, we believe despite the temporary disruptions caused by COVID-19, India's infrastructure story continues to remain intact, as infrastructure development will continue to get the highest priority. As per latest report of IBEF (Feb'20), India requires investment worth Rs50 trillion (US$777.73bn) in infrastructure space by 2022 to have sustainable development. Further, the Union Budget 2020 provides a broader view beyond the current disruptions.

Exhibit 6: Key Highlights of Union Budget 2020 on Infrastructure

- India plans to spend US$1.4 trillion on infrastructure in the next five years.
- Massive push to the infrastructure sector with allocation of Rs4.56 lakh crore (US$63.2bn).
- Allocation of Rs66.77bn (US$9.25bn) for the Indian Railways, out of which Rs64.58bn (US$8.95bn) is capex.
- Rs38.99bn (US$540.53bn) to increase capacity of Green Energy Corridor Project along with wind and solar power projects.
- Water supply to be provided to all households in 500 cities.
- Allocation of Rs830.15bn (US$11.51bn) for road transport and highways.
- Allocation of Rs888bn (US$110.88mn) for upgradation of state government medical colleges (PG seats) at the district hospitals and Rs13.61bn (US$188.63mn) for government medical colleges (UG seats) and government health institutions.

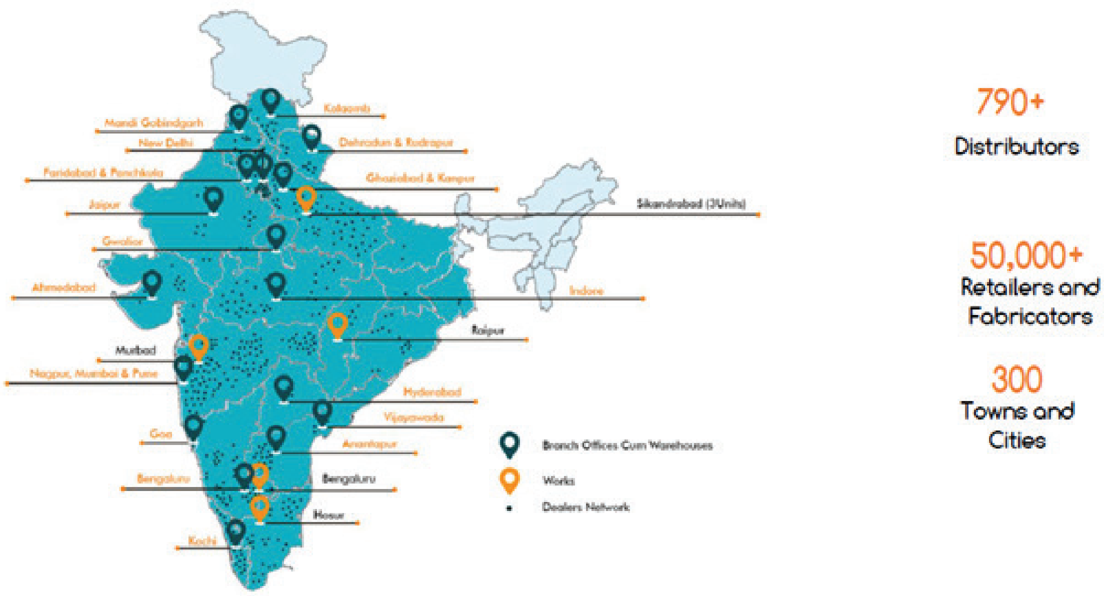
Source: Company, RSec Research

Mega Airport Development Plan – Huge Opportunity: We believe COVID-19 will certainly affect APAT's performance in the near-term, approval of its products in prestigious projects i.e. Navi Mumbai, Jewar, showcases its strength. Furthermore, the government plans to establish ~100 airports in the next 15 years. Among them, 70 airports will be at new locations, while the rest will be second airports or expansion of existing airfields to handle commercial flights. These high-ticket projects are expected to drive demand for steel tubes and pipes and APAT with its ready capacity of 2.55Mn MTPA would cash in on the projected infrastructure growth in India.

II. Market Leader in ERW Pipe Segment – Advantage

APAT manufacturers ERW Electric Resistance Welded (ERW) steel pipes by using Hot Rolled Coil (HRC) steel. The Company is a dominant player (with ~40% market share in organised market and 18% market share in the overall market) with a capacity of 2.55Mn MTPA spread across 10 plants in India. Its well spread out geographic reach serves to varied industries ranging from construction, infrastructure and agriculture.

Exhibit 7: APAT's Pan India Presence



Source: Company, RSec Research

Compared to peers, APAT has the highest capacity across regions making it a dominant player. We believe well spread out capacity in key geographies brings in a level of comfort for the dealers, especially in terms of logistic cost, which in our view is the key moat of APAT. APAT is the only largest player having pan-India presence with manufacturing as well as warehouse base near the key industrial towns, making it a preferred supplier for the contractors. Going ahead, we believe with improving spend for infrastructure development, the Company will be the biggest beneficiary of up-cycle with its ready capacity.

Exhibit 8: APAT's well spread out capacities

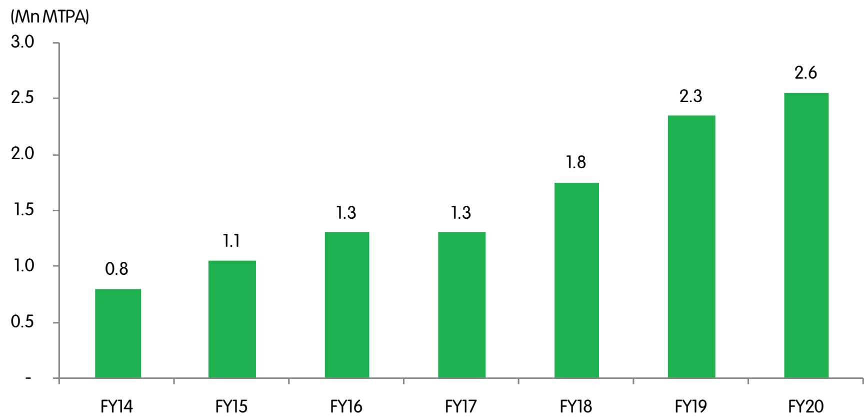
Capacities	No. of Plants			
Companies	APL Apollo Tubes	Hi-Tech Pipes	Rama Steel Tubes	Surya Roshni
North	4.0	2.0	2.0	1.0
South	3.0	1.0	1.0	1.0
Central & East	1.0	-	-	1.0
West	1.0	1.0	1.0	1.0
Total Capacities (Mn MTPA)	2.6	0.5	0.2	0.9

Source: Company, RSec Research

Market Leadership to Sustain on Strong Dealer Network & Variety of SKUs: Over the period, the Company has followed a strategic and disciplined approach for expansion. Capacity expansion has always been followed by increased Stock Keeping Units (SKUs) for new products followed by steady expansion of dealer network.

Capacity Expansion with Newer Technology: The Company has expanded capacity by adding newer technology like Direct Forming Technology (DFT and investing in Inline Galvanising Pipes (Apollo Tricoat) following acquisition of GI capacity from Taurus Value Steel & Pipes (part of Shankara Building Products). Its capacity has gone up from 0.8Mn MTPA in FY14 to 2.5Mn MTPA in FY20

Exhibit 9: APAT's Capacity



Source: Company, RSec Research

Aggressive capacity expansion has resulted in diversified product offerings. APAT has implemented DFT technology in FY19, which led to rise of SKUs to >1,500 in FY20 from 400 in FY17, while its peers continue to struggle in getting higher SKUs in place.

Exhibit 10: Growth in SKUs – APL Apollo Tubes vs. Peers

Company's Name	No of SKUs
APL Apollo Tubes	>1,100
Hi-Tech Pipes	>500
Rama Steel Tubes	>300
Surya Roshni	>600

Source: Company, RSec Research

We believe APAT's strong product portfolio makes an attractive proposition for its dealers, as increased range of products fits in required criteria of various clients. While the Company has added higher number of dealers, its peers continue to struggle to improve their dealer network. APAT's dealers count stood at >790 as on 9MFY20, while its closest peer Hi-Tech Pipes' dealers count stood at half mark.

Exhibit 11: Distribution Reach – APL Apollo Tubes vs. Peers

Companies	No of Distributors
APL Apollo Tubes	>700
Hi-Tech Pipes	>350
Rama Steel Tubes	>300
Surya Roshni	>250

Source: Company, RSec Research

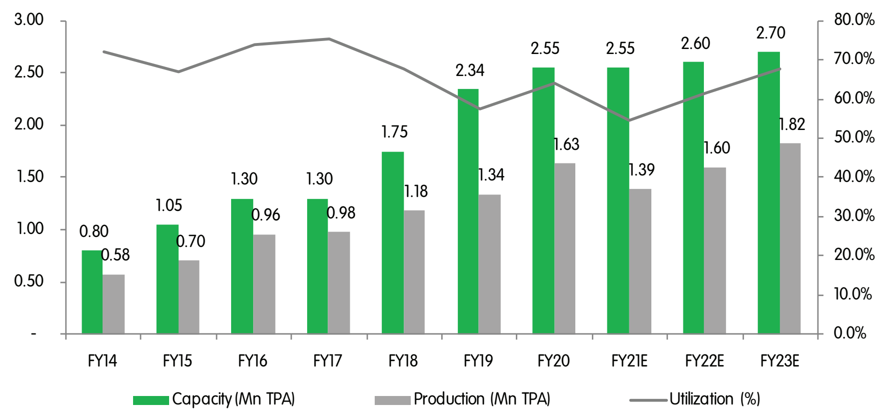
Channel Financing as Entry Barrier – Advantage: Most regional players have not been able to compete with APAT, on the back of APAT's strategy of extending channel financing facility to its dealers, which helps the dealers to smoothen cash-flow. We believe it will act as the biggest lever to tide over the COVID-19 crisis. APAT's fruitful relationship with the dealers, albeit with main focus on the customers with vast product portfolio, and channel financing act as strong barrier for any new player/existing player to enter into the business.

III. Higher Utilisation & Efficient Financial Management

The Company has the key factors i.e. increased capacity, extensive product portfolio and strong dealership network to ensure next leg of growth. The Management continues to emphasise on improving utilisation, which is visible despite volatile steel prices (22% YoY growth in volume in FY20), while the other industry players continued to struggle to deliver lower volume growth (+15% YoY in FY20) vs. APAT.

Looking ahead, we believe the Company has enough legroom to improve its utilisation rate from the current level of ~65%. Notably, even at the current utilisation rate, APAT remains on track to deliver 20% growth with minimal capex in FY22E. We believe with low requirement of capex, APAT is likely to be Free Cash Flow positive soon.

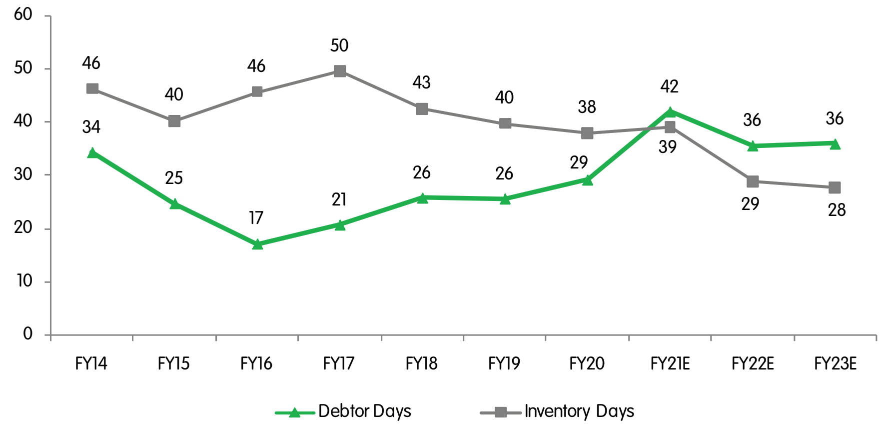
Exhibit 12: APAT's Capacities & Utilisation



Source: Company, RSec Research

Despite steady expansion of dealership network, APAT has been able to maintain its debtor days at 30 led by channel financing, while its peers continue to depend on balance-sheet size to fund working capital needs. The Company has managed to keep its working capital lean, which is evident from decreasing inventory days (45 days in FY16 to 30 days in FY20).

Exhibit 13: APAT's Inventory & Debtor Days



Source: Company, RSec Research

Outlook & Valuation

Despite volatile steel prices, APAT has delivered a strong volume growth in FY20, and we expect the similar performance to continue once the economy comes out of COVID-led disruptions. However, further extension of the ongoing lockdown, if any, is likely to have negative impact on APAT's FY21E performance. We strongly believe that India's infrastructure story continues to remain intact, while APAT being a long-term play will tide over the near-term headwinds.

In light of the uncertainties led by COVID-19 pandemic, we have presented three scenarios for APAT (Bull Case, Bear Case & Base Case) to capture slower, faster and modest recoveries.

- **Bull Case:** In Bull case scenario, we expect a faster recovery on volume front followed by less volatility in HRC prices. We expect volume to recover by 5% in FY21E followed by double-digit growth in FY22E and FY23E. EBITDA margin may come under some pressure, which is expected to result in 37% decline in PAT in FY21E. Return ratios too are expected to decline but expected to recover sharply in FY22E and FY23E.

Exhibit 14: Bull Case Scenario

(Rs mn)	FY19	FY20	FY21E	FY22E	FY23E	CAGR (%)
Volume (MTPA)	1,339,174	1,633,646	1,715,328	1,921,168	2,228,555	10.9
YoY (%)	13.1	22	5	12	16	
Total Sales	71,523	75,962	72,098	84,709	100,228	9.7
YoY (%)	???`	6.2	-5.1	17.5	18.3	
EBITDA	3,928	4,685	3,931	5,283	5,878	7.9
YoY (%)	5.9	19.2	-16.1	34.4	11.2	
EBITDA Margin (%)	5.5	6.2	5.5	6.2	5.9	
PAT	1,482	2,499	1,580	2,617	3,227	8.9
YoY (%)	-7.4	68.6	-36.8	65.6	23.3	
PAT Margin (%)	2.1	3.3	2.2	3.1	3.2	
EPS	62.2	100.5	63.5	105.2	129.8	8.9
YoY (%)	-8.1	61.7	-36.8	65.6	23.3	
RoCE (%)	20	19.4	13.1	17.4	19	
RoE (%)	16.5	21.9	11.3	16.6	17.8	

Source: Company; RSec Research

- **Bear Case:** In Bear case scenario, we expect APAT's volume to fall sharply in FY21E and witness slower recovery in FY22E and FY23E. EBITDA margin is also likely to remain in a tight band, while PAT is expected to remain under pressure, leading to 11.4% negative CAGR over FY20-FY23E.

Exhibit 15: Bear Case Scenario

(Rs mn)	FY19	FY20	FY21E	FY22E	FY23E	CAGR (%)
Volume (MTPA)	1,339,174	1,633,646	1,306,917	1,437,608	1,610,121	-0.5
YoY (%)	13.1	22	-20	10	12	
Total Sales	71,523	75,962	48,422	56,345	64,999	-5.1
YoY (%)	34.1	6.2	-36.3	16.4	15.4	
EBITDA	3,928	4,685	2,328	3,698	4,169	-3.8
YoY (%)	5.9	19.2	-50.3	58.8	12.7	
EBITDA Margin (%)	5.5	6.2	4.8	6.6	6.4	
PAT	1,482	2,499	434	1,285	1,739	-11.4
YoY (%)	-7.4	68.6	-82.6	195.8	35.3	
PAT Margin (%)	2.1%	3.3%	0.9%	2.3%	2.7%	
EPS	62.2	100.5	17.5	51.7	69.9	-11.4
YoY (%)	-8.1	61.7	-82.6	195.8	35.3	
RoCE (%)	20.03	19.44	6.16	11.37	13.35	
RoE (%)	16.45	21.89	3.24	9.20	11.68	

Source: Company; RSec Research

- **Base Case:** In Base case scenario, we have neither been too negative nor too positive. Hence, we expect a decent volume recovery in FY22E, while FY21E is expected to end with 15% degrowth. We expect EBITDA margin to remain in 4%-7% range, while PAT is expected to witness a modest recovery.

Exhibit 15: Base Case Scenario

(Rs mn)	FY19	FY20	FY21E	FY22E	FY23E	CAGR (%)
Volume (MTPA)	1,339,174	1,633,646	1,387,976	1,598,270	1,824,731	3.8
YoY (%)	13.1	22	-15	15.2	14.2	
Total Sales	71,523	75,962	53,061	64,976	76,357	0.2
YoY (%)	34.1	6.2	-30.1	22.5	17.5	
EBITDA	3,928	4,685	2,071	4,492	5,366	4.6
YoY (%)	5.9	19.2	-55.8	116.9	19.5	
EBITDA Margin (%)	5.5	6.2	3.9	6.9	7.	
PAT	1,482	2,499	202	1,988	2,701	2.6
YoY (%)	-7.4	68.6	-91.9	883.6	35.9	
PAT Margin (%)	2.1	3.3	0.4	3.1	3.5	
EPS	62.2	100.5	8.1	79.9	108.6	2.6
YoY (%)	-8.1	61.7	-91.9	883.6	35.9	
RoCE (%)	20.0	19.4	5.2	15.5	18.3	
RoE (%)	16.45	21.89	1.52	14.11	17.06	

Source: Company; RSec Research

Whilst we believe growth in top-line and bottom-line to remain subdued in FY21E, it is expected to pick-up pace from 2HFY21E onwards. Hence, we expect its revenue, EBITDA and net profit to clock 1%/4%/2.6% CAGR over FY20-FY23E. Further, we believe that APAT deserves premium valuation compared to peers on the back of lean working capital, low debt, and ready capacity. As per our analysis change in HRC prices has a very low correlation with APAT's EBITDA (refer Exhibit 19). **Hence, we have valued the stock on PE basis by assigning a multiple of 14x on FY23E EPS of Rs 108.6, arriving at a target price of Rs 1,520 and assign a "BUY" rating on the stock.**

Key Risks

- Volatility in HRC steel prices to impact EBITDA and profitability.
- Slowdown in infrastructure and construction segment followed by COVID-led disruptions to impact operating performance.
- Untimely exit of the key personnel may shake investors' confidence.

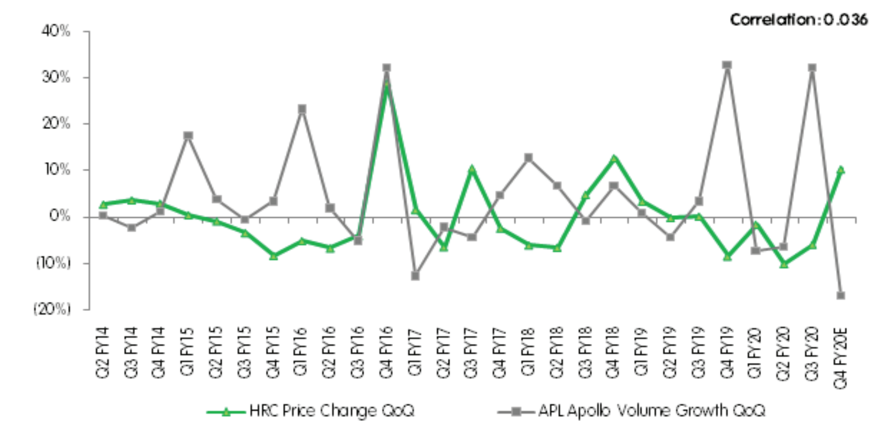
Financial Analysis

Volume Growth to be Driven by Infrastructure Demand despite Volatility in HRC Prices

APAT's volume largely depends on the demand for ERW pipes, which are driven by various infrastructure projects. Though COVID-led disruption is likely to affect APAT's volume prospects in FY21E, recent measures undertaken the government to restart infrastructure and construction activities as well lifting curbs on non-essential shops has brought relief for the Company as well as its dealers.

We examined the correlation between HRC prices and APAT's volume growth and realisation/tonne.

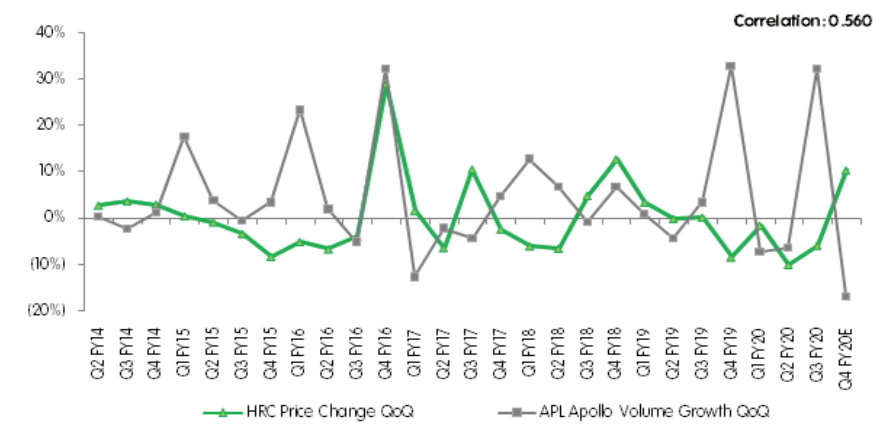
Exhibit 16: APAT's Volume Growth vs. Change in HRC Prices (QoQ)



Source: Company, RSec Research

Whilst the general perception suggests a direct relationship between HRC price and APAT's volume, (higher HRC prices leads to higher volume and vice-versa), our analysis suggests a very weak relationship (0.03) between them. We extended our analysis to find out whether volatility in HRC prices have any bearing on APAT's realisation/tonne.

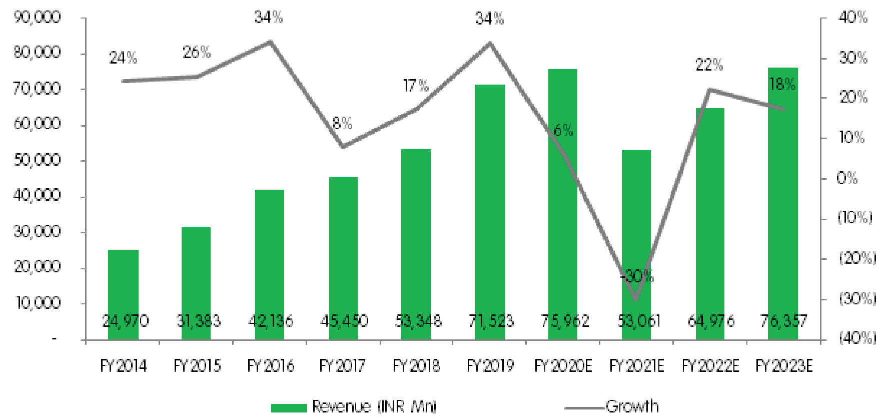
Exhibit 17: APAT's Change in Realisation/tonne vs. Change in HRC Prices (QoQ)



Source: Company, RSec Research

However, when we take a longer term view negative impact of COVID-led disruption in the near-term, APAT's volume and realisation are unlikely to get impacted in the long-term despite volatility in HRC prices as depicted in the above two exhibits. While APAT's volume will be driven by ground demand, better product-mix and new SKUs will ensure better realisation. Hence, while APAT's volume is expected to decline by 15% YoY in FY21E, swift recovery is most likely in FY22E and FY23E. While realisation/tonne is likely to remain subdued in FY21E, we expect a decent recovery in the ensuing years.

Exhibit 18: APAT's Revenue Growth



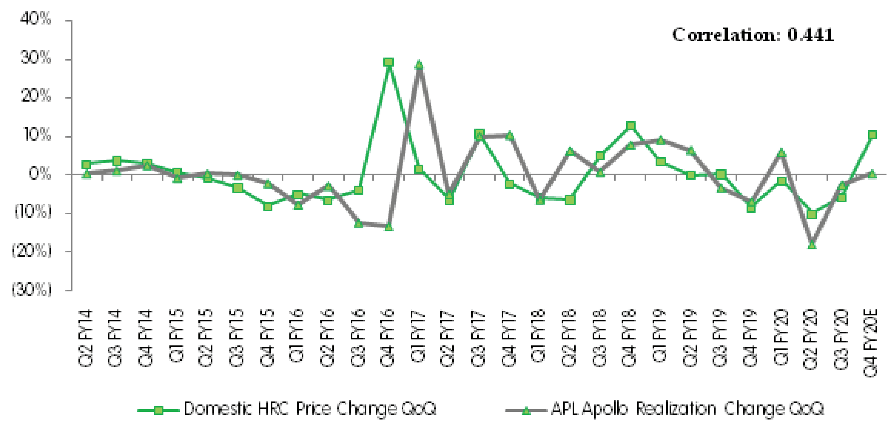
Source: Company, RSec Research

Operating Profit & Margin to Remain Healthy

APAT has sizeable capacity (2.55Mn MTPA) in India's overall steel sector (~112Mn MTPA). The Company is not only a significant player in structural steel segment but also in overall steel industry. This offers an edge to the Company to negotiate with the steel manufacturers to bring down RM cost/tonne. Further, reduced wastage led by adoption of Direct Forming Technology (DFT) will result in higher saving (in the range of 3-10% on RM cost) and improved realisation.

Looking ahead, we believe the Company will continue to focus on improving top-line, utilisation and realisation as well as maintain its EBITDA/tonne and EBITDA margin. We believe its EBITDA/tonne is unlikely to be hampered barring near-term headwinds despite fluctuation in HRC prices.

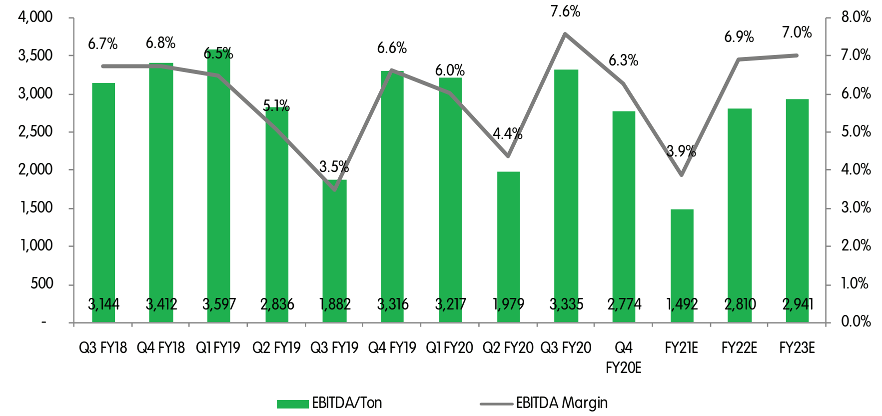
Exhibit 19: APAT's Change in EBITDA/tonne vs. Change in HRC prices (QoQ)



Source: Company, RSec Research

Hence, we expect APAT's EBITDA/tonne in Rs2,600-3,000 range, and peg EBITDA margin at 5.5-7%.

Exhibit 20: APAT's EBITDA/tonne and EBITDA Margin

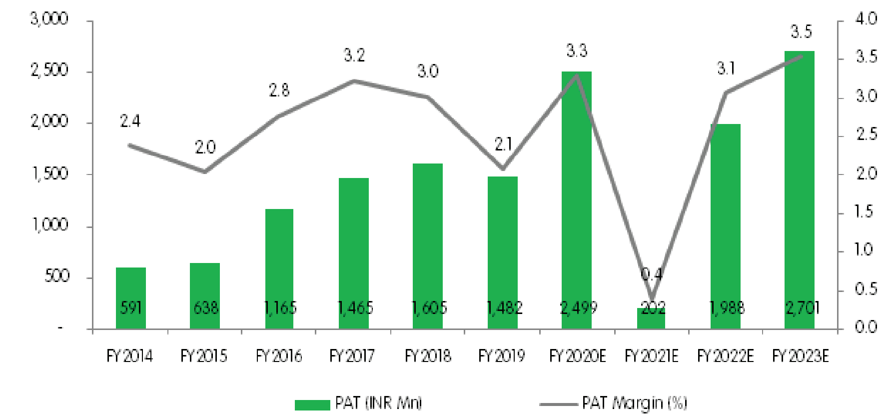


Source: Company, RSec Research

Improved Operating Efficiency & Lower ETR to Boost Profit

APAT's focus continues to remain on improving operating efficiency. While FY21E is expected to be weak in light of multiple headwinds including COVID-led disruptions, recovery is expected in 2HFY21E and a strong rebound is likely in FY22E. Looking ahead, we expect APAT's bottom-line to clock 16.2% CAGR through FY19-FY23E on the back of improved operating efficiency and lower ETR.

Exhibit 21: APAT's PAT and PAT margin

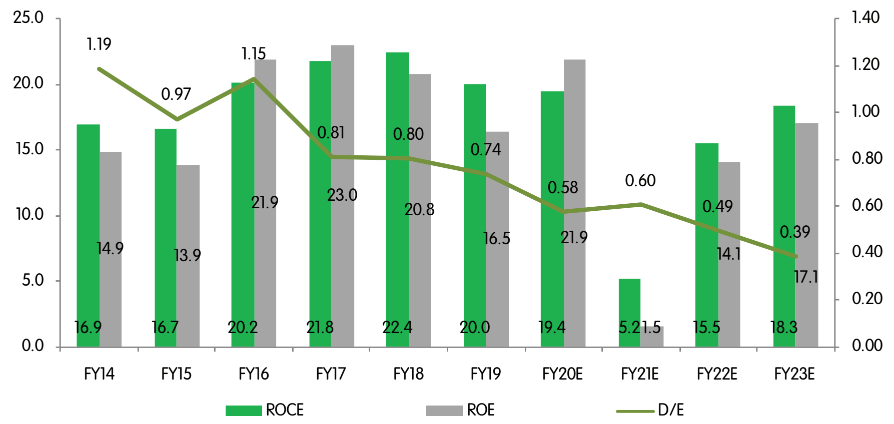


Source: Company, RSec Research

Healthy Return Ratios to Sustain on Lower Capex & Higher FCF

Despite being in a commodity industry, APAT has kept its return ratios (RoE and RoCE) in the excess of 20% on the back of tight control over working capital (cash conversion ~40 days), better utilisation of assets (Asset Turnover above ~5x) and minimal debt (below 1x). Despite challenges, we believe the Company will continue to record its RoE and RoCE in the range of 16% to 20%, respectively.

Exhibit 22: APAT's Return Ratios and Debt



Source: Company, RSec Research

Profit & Loss Statement

Y/E Mar (Rs mn)	FY19	FY20E	FY21E	FY22E	FY23E
Total Sales	**71,523**	**75,962**	**53,061**	**64,976**	**76,357**
COGS	63,077	64,856	45,791	54,574	64,176
EBITDA	**3,928**	**4,685**	**2,071**	**4,492**	**5,366**
Depreciation	643	916	945	1,028	1,078
Interest & Finance charges	1,134	1,043	972	949	845
Other Income	117	181	117	143	168
EBT (as reported)	2,269	2,906	270	2,657	3,611
Tax	787	407	68	670	910
PAT	**1,482**	**2,499**	**202**	**1,988**	**2,701**
Share in gain/loss of assoc.	-	-	-	-	-
RPAT	**1,482**	**2,499**	**202**	**1,988**	**2,701**
Extraordinaries adj.	-	-	-	-	-
APAT	**1,482**	**2,499**	**202**	**1,988**	**2,701**

Balance Sheet Statement

Y/E Mar (Rs mn)	FY19	FY20E	FY21E	FY22E	FY23E
Equity Share Capital	239	249	249	249	249
Reserves	9,402	12,943	13,145	14,533	16,634
Net worth	9,641	13,192	13,394	14,782	16,883
Total loans	7,101	7,601	8,101	7,301	6,501
Deferred tax liability (Net)	1,200	1,200	1,200	1,200	1,200
Capital Employed	**18,525**	**22,652**	**23,202**	**23,937**	**25,225**
Gross Block	11,737	16,537	17,837	19,037	20,337
Depreciation	1,631	2,546	3,492	4,520	5,598
Net block	10,106	13,991	14,345	14,517	14,739
CWIP	275	331	357	381	407
Investments	603	684	478	585	687
Inventories	7,835	5,686	4,140	4,486	5,275
Sundry debtors	5,433	6,243	5,670	6,587	7,950
Cash and bank	478	315	596	1,021	1,148
Loans and advances	1,039	912	1,061	1,170	1,145
Total Current assets	14,786	13,156	11,467	13,262	15,517
Total Current liabilities	9,214	7,795	5,880	7,157	8,417
Net Current assets	5,572	5,361	5,587	6,105	7,101
Capital Deployed	**18,525**	**22,652**	**23,202**	**23,937**	**25,225**

Cash Flow Statement

Y/E Mar (Rs mn)	FY19	FY20E	FY21E	FY22E	FY23E
PAT	1,459	1,600	1,482	2,499	1,988
Depriciation & Amortization	643	916	945	1,028	1,078
Incr/(Decr) in Deferred Tax Liability	206	-	-	-	-
(Incr)/Decr in Working Capital	891	48	55	(94)	(869)
Cash Flow from Operating	**3,221**	**3,462**	**1,203**	**2,922**	**2,910**
(Incr)/ Decr in Gross PP&E	(1,891)	(4,800)	(1,300)	(1,200)	(1,300)
(Incr)/Decr In Work in Progress	185	(56)	(26)	(24)	(26)
(Incr)/Decr In Investments	(592)	(81)	206	(107)	(102)
(Incr)/Decr in Other Non-Current Assets	(870)	(317)	(150)	87	58
Cash Flow from Investing	**(3,168)**	**(5,254)**	**(1,270)**	**(1,245)**	**(1,370)**
(Decr)/Incr in Debt	577	576	348	(653)	(813)
(Decr)/Incr in Share Capital	1	10	-	-	-
Dividend	(402)	(480)	-	(600)	(600)
Cash Flow from Financing	**357**	**1,628**	**348**	**(1,253)**	**(1,413)**
Incr/(Decr) in Balance Sheet Cash	410	(163)	281	425	127
Cash at the Start of the Year	68	478	315	596	1,148
Cash at the End of the Year	478	315	596	1,021	1,148

Key Ratios

Y/E Mar	FY19	FY20E	FY21E	FY22E	FY23E
Growth (%)					
Total Sales	34.1	6.2	(30.1)	22.5	17.5
EBITDA	5.9	19.2	(55.8)	116.9	19.5
APAT	(7.7)	68.6	(91.9)	883.6	35.9
Profitability (%)					
EBITDA Margin	5.5	6.2	3.9	6.9	7.0
Adj. Net Profit Margin	2.1	3.3	0.4	3.1	3.5
ROCE	20.0	19.4	5.2	15.5	18.3
ROE	16.5	21.9	1.5	14.1	17.1
Per Share Data (Rs.)					
AEPS	62.2	100.5	8.1	79.9	108.6
Reported CEPS	94.9	137.3	46.1	121.3	151.9
BVPS	404.2	530.4	538.6	594.4	678.8
Valuations (x)					
PER (x)	20.1	12.4	153.8	15.6	11.5
PEG (x)	(2.4)	0.2	(1.6)	0.0	0.3
P/BV (x)	3.0	2.3	2.2	2.0	1.8
EV/EBITDA (x)	9.1	8.0	18.3	8.3	6.8
EV/Net Sales (x)	0.5	0.5	0.7	0.6	0.5
Dividend Yield (%)	1.17	1.34	0.00	1.68	1.68
Turnover days					
Debtor Days	25.6	29.1	41.9	35.5	35.9
Payable Days	42.1	47.9	54.5	43.6	44.3
Gearing Ratio					
D/E	0.74	0.58	0.60	0.49	0.39

Company Overview

APL Apollo Tubes Ltd. (APAT), which established in 1986 as Bihar Tubes, started production of MS Black pipes at its Sikandarabad unit with an initial capacity of 6,000Mn MTPA. Within 3 years, it scaled up its capacity to 24,000Mn MTPA and today with total installed capacity of 2,550,000MTPA it is the leading manufacturer of ERW Steel tubes and pipes in India. The Company has pan-India presence with units strategically located in Sikandarabad (4 units), Malur, Bengaluru, Hosur, Dujana, Raipur, Murbad and Telangana. APAT's multi-product offerings include >1,100 varieties of pre-galvanised tubes structural ERW steel tubes, galvanised tubes, MS black pipes and hollow sections. APAT's vast 3-tier distribution network comprised of >790 dealers spread across India, with warehouses cum-branch offices in >29 cities. APAT also has arranged low-cost funds for its dealers, which has strengthened its relations with the distribution partners. APTL has three wholly owned subsidiaries as on 31st March 2020 i.e. Shri Lakshmi Metal Udyog (SLMUL), Apollo Metalex (AMPL), and Blue Ocean Projects. SLMUL holds 50.6% in Apollo Tricoat Tubes (ATTL), making it a step-down subsidiary of APAT.

Key Brands

Product Category	Brand	Application
Apollo Structural	Fabritech, Build, DFT	Residential, Commercial and Infrastructure
Apollo Z	Coastguard	Galvanised structural steel construction material: Residential, Commercial and Infrastrcture
Apollo Build	Green, Bheem, Strenx	Galvanised structural steel construction material: Residential, Commercial and Infrastrcture
Apollo Standard	Fireready, Agri	Construction Material, Industrial
Apollo Tricoat	Tricoat, Plank, Signature, Elegant, Chaukhat	Home Improvement Applications

Source: Company; RSec Research

Change in Ratings

We have now only **BUY and SELL** Recommendation and have discontinued HOLD Recommendation.

We now have **2 Year Target Price** and have discontinued with 1 year Target Price.

Signed By

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Ankit Merchant

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